

The University of Chicago

GOVERNMENT CORPORATIONS AND
FEDERAL FUNDS

A PART OF A DISSERTATION SUBMITTED TO THE
FACULTY OF THE DIVISION OF THE SOCIAL SCIENCES
IN CANDIDACY FOR THE DEGREE OF DOCTOR OF
PHILOSOPHY

DEPARTMENT OF POLITICAL SCIENCE

1936

By
JOHN McDIARMID

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Government Corporations and Federal Funds.* The increasing use of the government corporation in the conduct of governmental business enterprises is one of the most significant of recent trends in public administration. Indeed, the corporate device represents one answer to the charge that government is so poorly organized and so beset by red tape that public operation of economic enterprise is inevitably sluggish and inefficient. Most notably during the mobilization crisis of 1917 and the depression years following 1929, when speedy and vigorous action was needed, the federal government has relied heavily upon government corporations which could cut through red tape and "get things done."¹ Also in more normal times, however, particular enterprises somewhat isolated from regular governmental activities have been carried on in corporate form.²

The use of federal funds by these corporate agencies raises the serious problem of reconciling managerial freedom and efficiency with adequate controls, responsibility, and accountability. Without exception, the government corporations have enjoyed a measure of freedom in financial matters which differentiates them from the regular departments and establishments in the federal administrative branch. Even Federal Prison Industries, Inc., which must observe all governmental laws and regulations in matters of expenditure, and which is subject to complete audit control of the General Accounting Office, nevertheless enjoys a permanent appropriation, and consequently is freed from the necessity of annual appearances before Congress in order to secure funds. At the other extreme, such agencies as the Inland Waterways Corporation have the perennial use of their capital, freedom in expenditures from regular governmental procedures, unrestricted power to retain and utilize earnings, and complete freedom from the jurisdiction of governmental accounting and auditing officers. In between these extremes, the majority of corporations enjoy varying degrees of freedom—a freedom in some cases rather

* This subject is treated more fully in the author's forthcoming monograph on government corporations.

¹ For a full account of United States experience with the wartime corporations, see H. A. Van Dorn, *Government-Owned Corporations* (1926). A list of the more important "recovery" corporations would include: Reconstruction Finance Corporation, Tennessee Valley Authority, Home Owners' Loan Corporation, Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, Commodity Credit Corporation, Electric Home and Farm Authority, Export-Import Banks, Federal Subsistence Homesteads Corporation, Federal Surplus Commodities Corporation, R.F.C. Mortgage Company, Federal Farm Mortgage Corporation, Tennessee Valley Associated Coöperatives, Federal Prison Industries, Inc., and the banks for coöperatives and production credit corporations within the Farm Credit Administration structure.

² For example, the Panama Railroad Company, the federal land banks, the federal intermediate credit banks, and the Inland Waterways Corporation.



clearly outlined in the statutes, in others the subject of differing interpretations and even dispute.³ For example, the Commodity Credit Corporation is expressly authorized to utilize its earnings in operation;⁴ the Electric Home and Farm Authority has asserted and acted upon a similar power, in the absence of statutory provisions and in opposition to the contention of the Comptroller-General.⁵

The primary reason for extending to government corporations a large measure of financial freedom has to do with the nature of the activity which is undertaken. With but few exceptions, the corporate device has been utilized in the conduct of business undertakings of a character ordinarily associated with private enterprise, rather than in the administration of functions more clearly "governmental." Thus, the majority of federal corporations have been directly engaged in banking and credit activities; others have operated transportation services in particular localities; still others have engaged in such business undertakings as the purchase and distribution of foodstuffs, the production and sale of hydroelectric power, and the construction and maintenance of housing facilities. These functions are of a dynamic nature which demands different treatment from that afforded routine governmental activities. Hence, it has been realized that regardless of the value of general restrictions and regulations for controlling the financial transactions of the relatively stable old-line departments, the successful entry of the government into commercial and competitive fields demands flexibility and an absence of red-tape in administration. This flexibility might have been achieved in several ways. There is undoubtedly much truth in the following statement of Mr. Louis B. Wehle: "To a great extent, the phenomenal growth of the government-controlled business corporation in America could have been avoided, if an early distinction could have been made between the static regulatory function and the dynamic business function, and if there could have been lent to the performance of the business function

³ The T.V.A. and the Merchant Fleet Corporation particularly have become involved in serious disagreement with the Comptroller-General over the proper interpretation of statutory provisions relating to the manner of expenditures, the utilization of earnings, and the nature of the audit required. However, the financial powers of corporations created by executive officers under general statutory authorization to create necessary "agencies" are even more uncertain. Comptroller-General McCarl in effect destroyed the Public Works Emergency Housing Corporation by refusing to sign a warrant transferring funds to that agency. (Decision of January 11, 1934.)

⁴ 49 Stat. 4.

⁵ Mr. McCarl's contention that the E.H.F.A. earnings must be covered into the Treasury and withdrawn only on accountable warrants is contained in an unpublished letter of December 14, 1935. A similar dispute with the Export-Import Banks was settled when Congress expressly sanctioned the position taken by corporation officials (49 Stat. 4).

by departmental officers a reasonable freedom from abstractly sound, yet antiquated, restrictions upon their procedure."⁶

However, the answer of Congress to the need for flexibility in commercial enterprises has been the government corporation. The case of the Federal Barge Lines is an excellent illustration. From 1920 until 1924, this war-time heritage was operated under the Inland and Coastwise Waterways Service, an agency dependent upon annual congressional appropriations and subject to the regular governmental purchasing and auditing procedures. The results were discouraging, and particularly did the helplessness of the Service in the face of emergencies requiring immediate but unforeseen expenditures prompt officials to make an urgent request that Congress remedy the situation.⁷ As a consequence, the Inland Waterways Corporation was created in 1924 as an agency which could effectively test the economics of water transportation by operating the Federal Barge Lines in competition with the railroads and other carriers. Conducted along the lines of a private business, with ample funds and freedom from governmental restrictions, the I. W. C. has been very successful in contrast to its predecessor.⁸ Business enterprises, whether private or public, in order to be successful, must be able to meet emergencies promptly, make economical purchases, undertake needed improvements, and dispense with overly-legalistic and expensive forms and procedures. The fact that government corporations have been utilized primarily in the conduct of such enterprises is thus a major element in any explanation of the freedom which they enjoy.

Another significant factor has been the need for speed in carrying on a temporary or emergency program. The urgency of the situation was frequently pointed to as justifying the large powers and the flexibility granted the war-time corporations, and action and accomplishment took precedence over cautious restrictions and controls. Unquestionably, the temporary nature of the corporations created was a factor in securing the acquiescence of many who would have viewed any such grants of freedom on a permanent basis as fraught with danger.⁹ Perhaps to a slightly lesser

⁶ Louis B. Wehle, "Government-Controlled Business Corporations in America and Europe," 10 *Tulane Law Review* (1935), p. 94.

⁷ See the convincing testimony of General [then Colonel] Ashburn, before the House Committee on Interstate and Foreign Commerce, Hearings on H. R. 6647, 68th Cong., 1st sess., 1924.

⁸ See M. E. Dimock, *Developing America's Waterways* (1935). Eloquent tribute to the relative success of the I.W.C. is the admission of an avowed opponent of government operation that a "new formula" has been found by which government can be successful in business. See Herbert Corey, "Uncle Sam Finds a Formula for Competing with the Carriers," *Public Utilities Fortnightly*, Vol. VIII, No. 7 (1931), p. 389.

⁹ For example, consider the following statement of Paul M. Warburg, vice-governor of the Federal Reserve Board, with respect to the proposed War Finance

degree, the economic emergency of the past six years has influenced Congress and the President in defining the powers of the New Deal corporations. Illustrative is the H.O.L.C., which was organized to give prompt relief to distressed home-owners on as large a scale as possible. As Congressman Boylan said in the House when opposing restrictive provisions: "The gentleman knows this is emergency legislation. The gentleman knows also that were we to wait for civil service examinations, and what not, perhaps the exigency necessitating this legislation will have passed."¹⁰ Another example is the Reconstruction Finance Corporation, which was designed as a temporary agency and empowered to give immediate relief to financing institutions caught in the depth of the depression. Speed was an important factor, and in establishing an agency which could extend relief with as little delay as possible, Congress drew upon the emergency War Finance Corporation as a model. War-time and depression experience thus indicates that government corporations created for emergency purposes have been granted extraordinary powers largely because of the urgent need for quick and untrammelled action.

There have always been those who oppose the grant of any extraordinary financial powers to governmental agencies operating in corporate form. Various reasons are brought forth, but in general the argument progresses along somewhat the following lines: public money is expended and received, and Congress has the duty of exercising control thereover; general restrictions and procedures have been developed to insure honest administration, and they should be applicable to government corporations as well as to non-corporate agencies; there is no sound reason why corporations should not be subject to the jurisdiction of Congress' central "watch-dog," the General Accounting Office; and finally, there is great danger that "freedom in financial transactions" will grow into waste, extravagance, and irresponsibility.¹¹

There can be no disputing the fact that government corporations must

Corporation: "I would like to make it as emphatic as I can that I think this is only an emergency institution for this war, and that it would be a very unfortunate thing if an institution of this kind were to be permitted to exist after the conclusion of peace, and that is one of the reasons why I think these powers are better lodged in the corporation than in the government, because the corporation automatically ceases to have power to operate, yet upon the conclusion of peace the government could go on." (Hearings before House Committee on Ways and Means, February, 1918, pp. 41-42.) ¹⁰ 77 *Congressional Record*, p. 2569.

¹¹ See James M. Beck, *Our Wonderland of Bureaucracy* (1932), p. 128; O. R. McGuire, "Government by Corporations," 14 *Va. Law Rev.* (1928), 186; cf. views of the late Mr. Buchanan, 79 *Cong. Rec.*, p. 3261, and the late Senator Schall, *ibid.*, pp. 1546 ff. Comptroller-General McCarl always deplored the fact that many government corporations were "not subject to the statutory restrictions or safeguards which experience has taught are necessary in the expenditures of public funds," and repeatedly recommended "remedial" legislation by Congress.

be held adequately responsible for their stewardship of public funds. Under our form of government, this means that they must be held responsible to Congress, either directly or indirectly, since that body is the guardian of the public treasury. In the broadest sense, congressional control is maintained through the statutory definition of the major purposes to be served by a particular corporation. Such provisions vary widely in nature and in the length of detail, but every corporation is provided with these major statutory guiding lines, and all financial operations must be governed accordingly. This is true not only of the corporations expressly created by federal statute, but also of those organized under executive order. The case of the Public Works Emergency Housing Corporation is illustrative, since the Comptroller-General and the Attorney-General concurred in ruling that the corporate powers of that agency could not legitimately exceed those necessary to carry out the public-works program as outlined by Congress in the National Industrial Recovery Act.¹²

Congressional determination of the major purposes and policies of government corporations is indisputably desirable. Within this larger framework, however, there are several alternative degrees of control. On the one hand, such detailed regulations and restrictions may be imposed in the statutes that administration is hampered and the advantages of the corporate device nullified. At the other extreme, a corporation may within its vague statutory guides enjoy complete freedom in financial transactions, and may be free from any periodic check-up by Congress or its agents, thus dangerously approaching irresponsibility. Finally, there is a large middle ground where administrative freedom may be so guided through adequate controls as best to serve the public interest. It is this latter field which needs to be outlined. Because of the great variation in organization, purposes, and activities which characterizes our federal corporations, generalization is hazardous, but in any event, the attempt to pick out some guiding considerations seems worth the effort.¹³

With regard to the supplying of capital, Congress has freed most of its corporate agencies from the necessity of annual appropriations by sub-

¹² The Comptroller-General's decision was rendered on January 11, 1934—that of the Attorney-General on February 7, 1934. Both are interesting commentaries on the creation of government corporations by executive officers.

¹³ Mr. Oliver P. Field's suggestion that Congress enact a general statute under which all federal corporations could be created calls attention to the unsatisfactory and haphazard legislative treatment of such agencies. However, one is inclined to wonder whether a statute drawn in the detail recommended by Mr. Field would not impose upon all corporations a dangerously rigid uniformity. Certainly, at the present time Congress could advance far in the development of guiding principles without danger of rigidity. See O. P. Field, "Government Corporations: A Proposal," 48 *Harvard Law Review* (March, 1935), p. 775.

scribing to an amount of capital stock varying according to the nature of the enterprise concerned. Where Congress has determined as a matter of policy the desirability of undertaking a particular business activity, and desires maximum efficiency and continuity of administrative policy in the conduct of that business, the practice of subscribing to capital stock is quite satisfactory. It leaves with Congress the determination of the amount which the government should invest in the activity, and yet has the following advantages over a system of annual appropriations: the danger of a half-completed program, curtailed by lack of funds, is minimized; the removal of uncertainty surrounding the annual supply of funds is conducive to continuity of policy and administrative efficiency; the danger of congressional interference in the details of administration, as through restrictive riders on appropriation bills, is done away with; and finally, the corporation's operations are not paralyzed for several weeks each year while laborious and detailed preparation is made for the annual appearance before congressional appropriations committees. A system of stock subscription, however, should by no means be made the cloak for uncontrolled expansion and entry into new fields of activity. The utilization of capital within the broad limitations and purposes of the incorporating statute should prevent such abuses, and capital outlays in new though related fields should require express congressional authorization. Illustrative are the periodic expansion of R. F. C. lending powers through congressional action,¹⁴ and the extension of I. W. C. activities to additional river systems.¹⁵ It is where a field of business activity can be fairly well delineated and congressional policy with respect thereto well-defined, that the corporate device, with its permanent capitalization, reaches its greatest serviceability as an administrative vehicle.

In addition to initial capitalization, many of the federal corporations have secured supplementary funds through their borrowing power.¹⁶ This is particularly true of the banking and credit corporations.¹⁷ It has been the practice of Congress to place a maximum limitation upon the borrowings of the several corporations, and this seems to be a desirable yet not too restrictive measure of control. For the most part, borrowings must be made on the corporation's own credit and security, and thus there is a

¹⁴ See *Reconstruction Finance Corporation Act, With Amendments*, currently compiled in R.F.C. offices, *passim*. ¹⁵ See Pub. No. 389, 74th Cong.

¹⁶ As an illustration, the United States Grain Corporation, in financing the purchase of the 1918 wheat crop, was able to borrow \$385,390,000 upon its own credit. See Frank M. Surface, *The Grain Trade During the World War* (1928), p. 444.

¹⁷ The occasional magnitude of these borrowings may be seen in the fact that through 1934 H.O.L.C. bonds totalling \$2,416,980,025 had been issued. *Second Annual Report of the Federal Home Loan Bank Board*, 1934, p. 87. As of September 30, 1935, notes of the R.F.C. totalling \$4,072,574,166.67 were outstanding. *Quarterly Report of R.F.C.*, September, 1935.

tangible advantage in sound condition and good management. Occasionally, however, the guaranty of corporation bonds has been resorted to by the government in order to secure needed funds on the most favorable terms.¹⁸ The sacrifice of self-reliance has been justified on the grounds of the urgency of the program concerned and the immediate need of funds. In the case of activities primarily of an emergency and relief nature, such as the work of the R.F.C. and the H.O.L.C., the justification seems sufficient, whereas in other more permanent corporate undertakings the government guaranty of borrowings is not desirable. Where large bond issues are concerned, and particularly where government guaranty is provided, Congress has often required the approval of the Secretary of the Treasury in corporation borrowings. This is done in order to secure harmony with the borrowing activities of the government itself, and such an arrangement provides a reasonable and desirable measure of control.

Experience indicates that the majority of business enterprises carried on by government corporations cannot be subjected to the general restrictions and regulations which usually surround the expenditure of public funds without seriously endangering efficiency and economy. This fact has been appreciated by Congress, and most of the corporations have been exempted in practice, although it is only in recent years that express statutory authorization has been given government corporations to "determine the manner" in which their expenses shall be incurred, allowed, and paid.¹⁹ In the conduct of a complex banking business, it is inevitable that immediate action without compliance with governmental red-tape will continually be required. Let us take an illustration from the experience of the Export-Import Bank. An American manufacturer selling goods abroad wishes to know, before submitting his bid, the terms on which the bank will finance him. A protracted delay means loss of the business. Unless the Bank can make an immediate commitment, without submitting it to the Comptroller-General for approval, such applicants cannot be given financial assistance. A huge construction program like that of the T.V.A. can be most efficiently carried on if purchases and contracts are made intelligently, without blind adherence to rigid rules regarding acceptance of the lowest bid, the drawing of lots in cases of identical bids, etc.; the engineering judgment so valuable to private construction undertakings is just as valuable when government takes upon itself similar activities.²⁰ Purchasing operations like those of the

¹⁸ Notably in the case of the R.F.C., the H.O.L.C., the Farm Mortgage Corporation, and the T.V.A.

¹⁹ R.F.C. (47 Stat. 6), Federal Deposit Insurance Corporation (48 Stat. 94), Farm Mortgage Corporation (48 Stat. 172), H.O.L.C. (48 Stat. 132), Federal Savings and Loan Insurance Corporation (49 Stat. 298).

²⁰ For a thorough exploration of this question, see Chairman Morgan's testi-

Panama Railroad Company's commissary division can be successful only if discretion and ingenuity may be exercised.²¹ Advertising for bids is quite satisfactory as the normal procedure in purchasing matters, but when as a strict requirement it prevents taking advantage of favorable market prices in particular instances, the net result is an added expense that should not be inflicted upon a business enterprise.

The importance of the purchasing problem is much greater for some of our federal corporations than it is for others. In the case of the banking and credit agencies, the purchase of office supplies and equipment is such a small part of total financial operations as to be relatively insignificant. Such purchases can be standardized and conducted under regular governmental rules without serious handicap to administrative efficiency. Purchase of standard supplies from the regular government contractors may indeed be economical, while at the same time preventing possible abuses under a more flexible arrangement. On the other hand, where government corporations are concerned with the construction, maintenance, and operation of huge physical plants or the securing of products and materials for resale in a competitive market, the purchasing problem is of vital importance to the success of the enterprise, and purchases must be made with a freedom conducive to the greatest efficiency and economy.²² The Panama Railroad Company, the Inland Waterways Corporation, and the Tennessee Valley Authority are the best present-day examples of this type of corporation. During the fiscal year 1935, commitments of the T.V.A. for purchase of construction and plant equipment, furniture and fixtures, materials, services, and supplies approximated \$25,673,378.90.²³

The overhead cost of settling small claims against a business undertaking in the regular governmental manner—that is, through adjustment and settlement in the General Accounting Office—often would extend to

mony before the House Military Affairs Committee, *Hearings on "Tennessee Valley Authority,"* 74th Cong., 1st Sess., May, 1935, pp. 557 ff.

²¹ This division annually purchases over \$5,000,000 worth of merchandise for resale to the government, the Canal, and individuals and companies within the Canal Zone. In purchasing articles for resale, the Panama Railroad Company must consider their attractiveness to its customers, and must satisfy the whims and desires of such prospective purchasers rather than the bare requirements of a specification.

²² After years of experience in the management of one of England's public enterprises, Mr. Frank Pick made the following statement:

"Private enterprise may buy whatever it pleases and on whatever terms it pleases. A public utility undertaking, being open to challenge on preferences, on favouritism, on even baser grounds, protects itself by going to tender and accepting the lowest tender, other things being equal. *Yet this is maybe the least efficient way of buying.*" (*Public Admin.*, Vol. XIII, p. 135). Italics mine.

²³ *Annual Report of the Tennessee Valley Authority*, 1935, p. 51.

many times over the amount of the claim involved. Much more economical is the practice of the T.V.A. with respect to claims arising in connection with its reservoir clearance activities. Minor damages to cultivated ground are paid for on the spot, and the delays and expense involved in adjudication by the General Accounting Office are avoided. Other corporations, such as the farm credit banks and the Commodity Credit Corporation, write off small errors where payment or collection would involve unreasonable expense. A centralized and overly-formalized procedure in such matters is an unnecessary handicap to business success.

Occasionally, as in the case of Federal Prison Industries, Inc., with its relatively small expenditures, the application of regular statutes and rules does not work a hardship. This is exceptional, however, and it is interesting to note that even Comptroller-General McCarl, the chief advocate of strict regulation in expenditures, conceded now and again that the business operations of certain government corporations cannot be carried on successfully under regular procedures.²⁴ Mr. McCarl's plea that exemption, if intended by Congress, be expressly given, is a reasonable one, and explicit provisions in the R.F.C., H.O.L.C., and Federal Savings and Loan Insurance Corporation Acts are a marked improvement over earlier exemptions which, though apparently intended, were only implied.

One outstanding characteristic of most government corporations has been the sale of goods or services from which the receipts and earnings have comprised an essential part of the expendable funds. In contrast to receipts of the regular departments and establishments, corporation earnings have with few exceptions been available for operating expenses, capital improvements, and the building up of reserves and surpluses. The immediate deposit of earnings in the federal treasury as miscellaneous receipts has seldom been required. Sometimes the retention of earnings is expressly authorized in the statutes; sometimes the excess over operating expenses is committed to a particular use such as the building up of reserves; frequently, the right to retain and utilize earnings has been asserted as an implied corporate power.

There are several advantages, as Congress has recognized, in the availability of earnings for further use in the particular enterprise from which they arise. In the first place, such a system goes a long way toward making a successful corporation self-sufficient and beyond the need for further appropriations; the large majority of federal corporations meet their operating expenses from their own proceeds. Secondly, the in-

²⁴ See, for example, *Annual Report of the Comptroller-General*, 1932, p. 15. While making this concession in theory, the Comptroller-General continued to disallow expenditures which a reasonable application of the theory would seem to justify. See *infra*, note 36.

centive to keep operating expenses well within earnings and still show a surplus is a valuable aid to efficient operation. Corporation officials, whether in private or public fields, undoubtedly take pride in a commendable financial record, and strive to maintain and better previous standards. The Panama Railroad Company, with its enviable record, is a case in point.²⁵ In the third place, serious capital impairments may be prevented, and needed replacements and improvements may be made. For the banking and credit agencies, it is essential to maintain unimpaired capital and to build up reserves and surpluses with which to meet unexpected losses from loan transactions. If earnings may be retained for these purposes, the business position of the corporations is greatly strengthened. In the case of the F.C.A. corporations, earnings above operating expenses are required by law to be applied to the restoration of impairment, if any, of capital and paid-in surplus.²⁶ On the other hand, the Panama Railroad Company, the Inland Waterways Corporation, the Tennessee Valley Authority, and other such corporate enterprises which involve the maintenance and operation of large physical plants have a problem not shared by the banking agencies—namely, that of making needed replacements and improvements in physical plant and equipment. Reserves for depreciation must be accumulated, and such factors as increased business, technological advances, and competition will from time to time demand outlays for new property and equipment if the enterprise is to be progressively conducted. The Panama Railroad Company, for example, has been able to increase its capital assets from approximately \$11,000,000 in 1904 to \$34,600,660.12 in 1935 through the employment of part of the company's earnings for the purchase of rolling stock and equipment and the improvement of property.²⁷ Congressional sanction of the use of earnings for such purposes is very desirable. Finally, the use of earnings normally insures the availability of operating capital for meeting emergencies and unforeseen contingencies without expensive delays. One of the greatest blows to the Inland and Coastwise Waterways Service resulted from its inability to meet a serious emergency caused by an unprecedented drop in the river level in 1922. Much business was lost as a result of the fear of shippers that the service would be discontinued.²⁸ Such an eventuality would have been impossible if the Inland Waterways Corporation, with its power to retain earnings and build up reserves, had been in existence.

Empowering government corporations to retain and utilize earnings does not mean that the government is deprived of any ultimate profits

²⁵ See M. E. Dimock, *Government Operated Enterprises in the Panama Canal Zone* (1934). ²⁶ See, for example, 48 Stat. 259, 263.

²⁷ *Annual Report of the Panama Railroad Company, 1935*, p. 6.

²⁸ See Van Dorn, *op. cit.*, p. 220.

which may accrue. Thus, temporary agencies such as the war-time corporations or the R.F.C. have been acquired to turn over all assets upon liquidation, and rightly so. In the case of the more permanent corporations, provision may well be made for the return of any excess profits to the federal treasury—witness the annual dividends of the Panama Railroad Company.²⁹ However, profits such as those made by the P.R.C. are exceptional, and in operations such as the extension of credit, in which the policy of the government is to keep interest rates as low as possible while covering expenses, the question will not arise.

The problem which has been least satisfactorily settled in so far as our government corporations are concerned is that of providing suitable methods of accounting and auditing control. Some corporations are entirely free from any form of governmental audit, and the only periodic check-up of their financial transactions is that made in the annual audit conducted by private accountants. Others are subjected to all of the regular governmental procedures, and must submit complete accounts and supporting papers for a continuous audit by the General Accounting Office. The majority, however, have been on a middle ground which is often poorly defined, with the result that auditing matters become the subject of debates and frequently bitter disputes with the governmental accounting officers. Neither of the two extremes seems to secure the proper responsibility in the use of public funds together with the flexibility needed for efficient administration. However, while the ideal solution lies somewhere in between, it should be possible to define the procedure in such a way as to eliminate much of the uncertainty and bickering which have so frequently appeared in the past.

The subjection of all government corporations to the "auditing" control of the General Accounting Office as that agency is now constituted would be a serious mistake. The President's Committee on Administrative Management has quite rightly pointed out that the Comptroller-General's present function of allowing or disallowing current expenditures by governmental agencies results in inefficient administration, and is properly a function which should be lodged in the Treasury, i.e., within the administration itself.³⁰ In the conduct of a business enterprise, where flexible management is essential, detailed and legalistic expenditure control by an outside agency is *a fortiori* unsatisfactory. The advantages of the corporate device will best be preserved by retaining the comptrolling function within the corporation itself.

The question of auditing is quite different. The exercise of external

²⁹ The annual dividend to the government is 10 per cent, and the total paid into the treasury since 1904 is over \$12,000,000.

³⁰ *Report of the President's Committee on Administrative Management* (January, 1937), pp. 20 ff.

control through some system of periodic examination and post-audit of the accounts of government corporations should properly be in the hands of an independent governmental auditing agency. Neither the legalistic and formalistic emphasis of the General Accounting Office nor the employee-accuracy-and-honesty emphasis of the private auditing firm meets the need. Much good might be accomplished if the audit could be more than a financial or fidelity audit, if it could be a service or efficiency audit, by an agency having the power thoroughly to investigate operations and to make recommendations to Congress as to efficiency as well as honesty in administration. The work of the farm credit examiners, as they tend more and more toward efficiency audits, is a case in point; and T.V.A. Chairman Morgan's suggestion that the Comptroller-General furnish competent engineers at the Authority's expense to go over T.V.A. work, "to keep track of it, in any field that he wants to explore, to see whether it has a good honest tone to it, to see whether anything ought to be looked into further,"³¹ is somewhat along the same lines.

The best solution to the problem of providing our federal corporations with an external audit is contingent upon a redefinition of the functions of the General Accounting Office along the lines recommended by the President's Committee.³² Once this office became a real post-auditing agency, a particular division should have the specialized duty of auditing, thoroughly investigating, and making reports upon the financial operations of governmental business corporations. The personnel of such a division would have opportunity to become thoroughly familiar with, and hence more sympathetic toward, the aims and activities of the various corporations. The difference in nature between business enterprise and routine governmental activity should be clearly taken into account, and the audit governed accordingly.³³ Comparisons and constructive suggestions could be made, yet no interference in administration would be possible.

Short of this desirable change in the status of the General Accounting Office, other solutions must be found. Congress should, in the first place, clarify the relationship between corporations and the Comptroller-General. There should be no occasion for disputes such as that which has arisen in the case of the Tennessee Valley Authority over the "audit" required by statute. In such instances, it should be made clear whether Congress intends a complete submission of accounts and schedules, as Mr. McCarl maintained, or a post-audit in the corporation offices, as

³¹ *Hearings before House Military Affairs Committee*, May, 1935, p. 574.

³² *Report* (January, 1937), p. 23.

³³ For the differences between private or business auditing and the ordinary governmental audit, see D. H. Smith, *The General Accounting Office*, Service Monograph, Institute for Government Research (1927), p. 111.

contended by T.V.A. officials. If the Comptroller-General is to be given the power of auditing the accounts of government corporations, the least that can be done is to define clearly the nature of that audit.³⁴ A provision such as that in the amended T.V.A. act³⁵ to the effect that the corporation shall have opportunity to examine and answer the exceptions contained in such an audit before the report is made to Congress may well be included.

Where a number of related corporations are grouped together under an overhead organization such as the Farm Credit Administration, a satisfactory independent audit of individual corporation transactions can be made by the central agency. Such an arrangement makes unnecessary the regular controls usually applied to transactions of governmental agencies, and hence the subsidiary corporations should be entirely free from any direct control or audit by the General Accounting Office. The experience of the F.C.A. seems to offer encouragement to the further extension of the scheme. The central agency is sufficiently distinct from the subsidiary corporations to insure an independent examination of individual corporation transactions; and yet through familiarity and sympathy with the major objectives of the group as a whole it may lend to its examinations a reasonableness and sense of perspective which is greatly to be desired. Opportunity for improvement through comparison of the individual corporations is afforded, and an audit becomes a preliminary step to better and more efficient methods as well as a check on honesty in administration. Control of financial transactions may be made effective without imposing an administrative strait-jacket upon the operating units.

A final possibility is to free individual corporations from any control or audit by the General Accounting Office, as has been done in the case of the Panama Railroad Company, the Inland Waterways Corporation, and the Reconstruction Finance Corporation. Where the decision lies between this type of freedom, on the one hand, and complete General

³⁴ In the case of the Fleet Corporation, the fact that the statutory mandate was for the Comptroller-General to make an audit "in accordance with the usual methods of steamship or corporation accounting" apparently had little effect, and the corporation officials rightly complained that Mr. McCarl's audit was conducted along regular governmental lines, and with his usual approach. For example, exception was taken to such transactions as the following: compromise settlement of claims against the corporation when it had not been proved that "the action could be sustained at law"; expenditures for insurance on property in spite of the "long established policy of the Government not to carry insurance"; purchases of automobiles for use of corporation officials; and payment of premiums on fidelity bonds required of corporation employees. These practices, all quite common and legitimate for a private corporation, were nevertheless condemned by Mr. McCarl as being illegal for a governmental agency. See House Doc. 111, 71st. Cong., and House Doc. 217, 72d Cong.

³⁵ 49 Stat. 1081.

Accounting Office control as ordinarily exercised on the other, there are strong arguments in favor of the former. Where this choice is made, however, statutory provision should be made for periodic audits by reputable private firms as well as for financial reports by the corporations themselves. The Inland Waterways Corporation Act, which makes no mention of any audit or report whatsoever, goes to an unsatisfactory extreme.³⁶ In providing for the periodic audit, Congress might well place the selection of the private firm in the hands of some executive official or agency which is not directly responsible for the management of corporation activities.

The government corporation is primarily an administrative device, and is so designed. It reaches maximum administrative efficiency when granted a large measure of freedom in management and in financial matters. If it is used for partisan purposes or is otherwise mismanaged, its very virtues become vices. Desirable financial freedom becomes the shield of favoritism and corruption. Fortunately, the experience of the federal government with its corporate agencies is reassuring on this point. Corporation officials must and can be chosen for their ability and integrity without any reference to partisan or political considerations. The entire divorce of the Tennessee Valley Authority from spoils practices is only one of the encouraging signs in recent corporate developments. In the last analysis, the selection of public spirited and expert men to direct the operations of our government corporations is the real safeguard of the public interest, and when this is accomplished, the freedom conducive to progressive administration can profitably be granted.

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³⁶ 43 Stat. 360. It should be noted that in practice the I.W.C. makes annual reports to the Secretary of War and has its accounts audited once each year by certified public accountants.

